No. 2692

In the United States

Circuit Court of Appeals

For the Ninth Circuit.

ARTHUR A. KLINE,

Appellant,

vs.

THE ARIZONA MUTUAL SAVINGS AND LOAN ASSOCIATION, a Corporation, THE ARIZONA TRUST COMPANY, a Corporation, and SIMS ELY, as Receiver of the Arizona Mutual Savings and Loan Association and as Receiver of the Arizona Trust Company,

Appellees.

Brief of Appellant.

Upon Appeal from the United States District Court for the District of Arizona.

THOS. ARMSTRONG, Jr.,
ERNEST W. LEWIS,
Attorneys for Appellant,
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STATEMENT OF FACTS.

Arthur A. Kline, the plaintiff and appellant, was, prior to March, 1912, the owner of certain stock in the Arizona Mutual Building and Loan Association. This stock had been represented to him as maturing in January, 1912, (Transcript, p. 85). Not being able to collect the matured value he came to Phoenix, the office of the Loan Association, and there interviewed its officers. He was told that the reason his stock had not matured was that upon an investigation of its affairs by the state bank examiner certain loans were ordered written off, which reduced the dividends and prevented his stock from maturing. (Transcript, p. 98). Mr. Edwards, an officer of the Loan Company, told him that the Arizona Trust Company, of which he was also an officer and which company had been and was trying to acquire the stock of the Loan Association, might purchase

his stock, and an agreement was reached whereby the Trust Company bought the Kline stock for $5,532.00, its then book value, giving in payment its four months note secured by the collateral negotiable promissory notes and mortgages, all but one of which were unmatured, now claimed by the defendant and appellee the receiver of the Loan Association. (Transcript, pp. 90-92). The Kline stock, Trust Company note and collateral was upon March 1, 1912, placed in escrow with the Valley Bank of Phoenix under the further agreement that its cashier, Mr. Christy, should investigate the value of the collateral and if he approved it the stock should be delivered to the Trust Company and the note and collateral to Mr. Kline (Transcript, pp. 64-66). Mr. Christy approved the collateral April 29, 1912 (Transcript, p. 67, also 102).

Early in July, 1912, and after these matters had been concluded, a suit was commenced in the court below, entitled Clark, et al., vs. Arizona Mutual Savings and Loan Association and the Arizona Trust Company, wherein Sims Ely was appointed receiver of both companies. Mr. Kline was not a party to this suit.

Upon July 13, 1914, Mr. Kline commenced this suit against the defendants the Trust Company and the Loan Association and Sims Ely the Receiver, upon the note of the Trust Company and to foreclose his lien upon the collateral (p. 10, Transcript). The complaint is in the ordinary form (pp. 1-10, Transcript). The defense set up in the answer was that in the Clark litigation a decree had been entered adjudging that the Trust Company had at the time of the transaction with Kline

no title to the collateral pledged and that it belonged to the Loan Association and that any attempted transfer of this collateral from the Loan Association to the Trust Company was void; that a master had been appointed in the Clark litigation and a reference had for the purpose of determining and adjusting all claims against either the Trust Company or the Loan Association and that Kline should be compelled to present and litigate his claim therein, (pp. 14-17, Transcript).

Upon the trial the plaintiff and appellant introduced the principal and collateral notes and mortgages, the escrow agreement and the letter of the Valley Bank approving the collateral and the testimony of Mr. Kline as to the facts leading up to the sale of his stock to the Trust Company, substantially as recited above, and rested. (pp. 62-105), Transcript).

The defense announced it had no further evidence to offer other than the decrees in the Clark litigation which were received over the objection and exceptions of the appellant to the effect that Kline not being a party or privy to the Clark litigation and his interest and lien having initiated prior to the commencement of that suit he was not bound thereby. (pp. 105-107, Transcript).

A decree was entered that the plaintiff and appellant take nothing by his action other than that he be permitted to present his claim to the master appointed in the Clark suit (pp. 45-46, Transcript); from which judgment this appeal is perfected (pp. 49-57, Transcript).

ARGUMENT.

ASSIGNMENTS OF ERROR.

I.

That the Court erred in admitting in evidence the decree entered in the above-entitled court in the case of Charles W. Clark versus the Arizona Mutual Savings & Loan Association et al., dated February 27, 1913, and the decree entered in said court on the 12th day of March, 1914, in said last mentioned action, wherein said court did decree that at the time of the transfer by the Arizona Mutual Savings & Loan Association to the Arizona Trust Company of the assets of the said Arizona Mutual Savings & Loan Association, including the assets the subject of litigation herein, the Arizona Trust Company had no right, power or authority to receive from said Arizona Mutual Savings & Loan Association any of said assets and that said attempted transfer was void and of no effect, over the objections of complainant and appellant duly entered of record in said cause, to-wit:

> "We object to the competency and relevancy of the judgments themselves upon the ground that Arthur A. Kline was not a party to said litigation and that his interest, if any he had, initiated prior to the institution of the suit of Clark versus the Arizona Mutual Savings & Loan Association, et al., and, therefore, we are not bound by any decree which may be rendered in the Clark litigation";

to which ruling admitting said judgments the complainant and appellant then and there excepted, which exception was noted of record. (pp. 50-51, Transcript).

II.

The District Court erred in holding that the judgments entered by said Court in the said cause of Charles W. Clark, complainant, versus the Arizona Mutual Savings & Loan Association, et al., defendants, wherein it was decreed that the transfer of the assets of the Arizona Mutual Savings & Loan Association to the Arizona Trust Company was void, determined and established as against the complainant and appellant herein, he not being a party to said litigation and his rights, if any, having initiated prior to the institution of said cause of Clark versus the Arzona Mutual Savings & Loan Association, et al., that the Arizona Trust Company had no title to the collateral pledged to this complainant and that therefore this complainant had no right to the possession of said collateral as against the receiver Sims Ely, appointed in said cause of Clark versus the Arizona Mutual Savings & Loan Association, et al., (pp. 51-52, Transcript).

The foregoing assignments raise questions which can best be discussed together and for the convenience of the court we ask leave so to do.

Kline, prior to March 2, 1912, was a stockholder of the Arizona Mutual Building and Loan Association.

Upon that day he sold his stock to the Arizona Trust Company, taking its note for $5,532.00, the then value of his stock, which note was secured by the delivery in escrow of certain notes secured by real estate mortgages as collateral security for the payment of the principal note (pp. 64-66, also 91-92, Transcript).

In July, 1912, (four months later) was commenced the Clark litigation wherein it was adjudged that the transfer to the Arizona Trust Company of the assets of the Arizona Mutual Savings and Loan Association, including the collateral involved herein, was void.

The record in this case contains no evidence tending to establish the invalidity of the transfer from the Mutual to the Trust Company unless it be found in the Clark decrees. The answer raises no issue, independent of a plea of the Clark decrees, as to the invalidity of the transfer and no independent issue as to want of title in the Arizona Trust Company. The answer is that the Clark judgments establish the invalidity of the transfer and the want of title in the Trust Company, the assignor of Kline. There is no allegation of fraud, insolvency or want of corporate power nor offer of proof to avoid what, upon the face of the record, appears to have been perfect title in the Trust Company outside the plea and proof of the Clark judgments.

Unless the appellant Kline, is bound by the Clark decrees he was and is entitled to judgment as prayed in the bill.

"The assignee of a note is not affected by any litigation in reference to it beginning after the assignment," and "no one is privy to a judgment whose succession to the rights of property thereby affected occurred previously to the institution of the suit."

Freeman on Judgments, Sec. 162.
Brown v. Fletcher, 203 Fed. 70.
Ingersoll v. Jewett, 16 Blatchf. 378, Fed. Case No. 7039.
Carroll v. Goldschmidt, 83 Fed. 508.

Rooney v. Barnette, 200 Fed. 700; 119 C. C. A. 116.

The Clark suit was in no sense a proceeding in rem and the adjudication does not conclude strangers.

Aldridge v. Pardee, 24 Tex. Civ. App. 254; 60 S. W. 789, affirmed, Pardee v. Aldridge, 189 U. S. 429; 47 L. Ed. 883.

Even though Kline be regarded as a stockholder in the Arizona Mutual Savings and Loan Association, which he was not, at the time the Clark suit was commenced, he would not be bound by the decree.

Victor Talking Machine Co. v. American Graphophone Co., 189 Fed. 359, at 374.

ASSIGNMENT OF ERROR III.

Said District Court erred in holding and decreeing that the complainant, Arthur A. Kline, take nothing by his said action, and that he is not the owner nor entitled to the possession of any of the securities or assets, the subject of this litigation for the reason that all of the competent evidence introduced upon the trial of said cause shows that said Arthur A. Kline, on or about March 2, 1912, and more than five months prior to the institution of the cause of Charles W. Clark versus the Arizona Mutual Savings & Loan Association, et al., sold to the Arizona Trust Company stock in the Arizona Mutual Savings & Loan Association and in consideration therefor received of and from the Arizona Trust Company its certain promissory note due on or before July 1, 1912, in the sum of Five Thousand Five Hundred and Thirty-two Dollars ($5,532.00) with interest and attor-

neys fees, which note was and is unpaid, and that at the time of the execution and delivery of said note and to secure the payment thereof the said Arizona Trust Company endorsed in blank and delivered to the Valley Bank in pledge for the use of the said Arthur A. Kline certain negotiable promissory notes secured by mortgages on real estate in Arizona, as follows:

No.			
119.	E. E. Wardlop, Bisbee	$1,500.00	$1,500.00
246.	E. W. Booker, Globe	500.00	500.00
250.	E. E. Smith, et al., Wickenburg	339.25	400.00
253.	O. W. Jennings, et al., Wickenburg	688.00	800.00
268.	Thos. P. Alger, Safford	564.00	600.00
261.	Phoenix Construction Co., Phoenix	1,982.00	2,000.00
		$5,573.25	$5,800.00

and that at the time of the pledging of said notes to the said Arthur A. Kline each and all of said promissory notes, save and except No. 119, E. E. Wardlop, were unmatured and were in the actual possession of the said Arizona Trust Company and endorsed in blank by the Arizona Mutual Savings & Loan Association, and that at that time said Kline was entitled to rely upon and did rely upon such plenary evidence of title in said Arizona Trust Company, and by virtue of the pledge aforesaid did become entitled to the possesion thereof until said principal note was paid.

"Actual possession of a negotiable instrument payable to bearer or indorsed in blank is plenary evidence of title in the holder."

Collins v. Gilbert, 94 U. S. 753; 24 L. Ed. 170.

That the Trust Company was in actual possession of the notes pledged is clear. (Testimony of Kline, pp. 91-92, Transcript).

That the notes were endorsed in blank at the time of Kline's sale of his stock to the Trust Company is shown by the endorsements (pp. 70, 73, 76, 78, 80, 82, Transcript) and the testimony that they were receipted for by Mr. Christy, the bank cashier and escrow holder, the afternoon the sale was made, March 2nd (p. 92, Transcript). See also Escrow instructions, pp. 63-66, Transcript.

ASSIGNMENTS OF ERROR IV AND VI.

IV. The District Court erred in holding that as to unmatured notes pledged to said Kline; said Kline was not an innocent holder in due course (p. 53, Transcript).

VI. The District Court erred in holding that said Kline was not an innocent purchaser of said collateral for value (p. 54, Transcript).

One who takes a note as collateral security for a debt then created, and on the faith thereof, without notice of equities, is a holder for value.

Randolph on Commercial Paper, Sec. 993.

When a bill or note of a third party, payable to or-

der, is endorsed as collateral security for a debt contracted at the time of such endorsement, the indorsee is a *bona fide* holder for value in the usual course of business, and entitled to protection against equities and offsets and other defenses available between antecedent parties, provided, of course, that the bill or note transferred as collaterall security is itself at the time not over due. The doctrine rests upon clear grounds. There is an evident present consideration for the transfer of the collateral bill or note; a present change in the legal rights of the parties. And the text writers, supported by an almost unbroken train of decisions, agree that the endorsee is entitled to protection to the extent of the debt secured.

Daniel on Negotiable Instruments (6th Ed.) Sec. 824 (1).

In this case Kline sold his stock at its book value (the only value shown) to the Trust Company and received the note of the Trust Company for $5,532.00 and the collateral notes in payment therefor. (p. 92, also p. 98, Transcript).

Even if it be regarded as a transaction wherein collateral was furnished to secure an antecedent debt as suggested below (which theory we feel assured finds no support in the evidence) upon the record made the title of Kline is superior to that of the Receiver.

It is generally conceded that the conflict of authority discussed * * * * has been settled in those states which have adopted the statute (negotiable instrument law) so that it is the rule in those states, in view of the sev-

eral provisions of the statute, that one who takes a note merely as collateral security for a pre-existing debt is regarded as a holder for value.

Daniel on Negotiable Instruments, (6th Ed.) Sec 831 a.

"Value is any consideration sufficient to support a simple contract. Any antecedent or pre-existing debt constitutes value, and is deemed such whether the instrument is payable on demand or at a future time.'

Rev. St. Arizona, 1901, Par. 3328, idem sec. 25.

"Where value has at any time been given for the instrument, the holder is deemed a holder for value in respect to all parties who become such prior to that time."

Rev. St. Arizona, 1901, Par. 3329, idem sec. 26.

"Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value to the extent of his lien."

Rev. St. Arizona, 1901, Par. 3330, idem sec. 27.

"An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof; if payable to bearer, it is negotiated by delivery; if payable to order, it is negotiated by the indorsement of the holder, completed by delivery."

Rev. St. Arizona, 1901, Par. 3333, idem sec. 30.

"A holder in due course is a holder who has tak-

en the instrument under the following conditions:

1.—That the instrument is complete and regular upon its face.

2.—That he became the holder of it before it was overdue, and without notice that it had been previously been dishonored, if such was the fact.

3.—That he took it in good faith and for value.

4.—That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."

Rev. St. Arizona, 1901, Par. 3355, idem sec. 52.

"Holder" means the indorsee or payee of a bill or note, who is in possession of it or the bearer thereof.

Rev. St. Arizona, 1901, Par. 3487 (184), renumbered as Sec. 190, Laws 1905, p. 24-27.

While the plaintiff, Kline, went much further in his proof than the necessities of the case might technically have required to eliminate any question as to whether he had notice of the defect in the title of the Arizona Trust Company to the notes negotiated to him, the evidence establishes:

(1) The instruments are complete and regular upon their face. (Transcript, pp. 66 to 82).

(2) All were unmatured at the time of negotiation except the Wardlop note which was past due. (Transcript, pp. 66 to 82).

(3) Kline on March 2, 1912, sold stock in the Arizona Mutual Savings & Loan Association to the Arizona Trust Company of the book value of $5,532 (the only value shown), for which he took the principal note of

the Trust Company for $5,532 with interest and attorney fees, secured by the notes and mortgages in suit. All of the collateral notes were at the time in the possession of the Trust Company and were endorsed in blank by the Loan Association and the Trust Company. (Transcript, pp. 64-82, 92 and 98).

This would appear to satisfy the third condition of the statutes cited above,i. e. "that he took it in good faith and for value".

(4) At the time the notes were negotiated Kline had no notice of any defect in the title of the Trust Company. (Testimony of Kline, Transcript, pp. 83-102).

A vigorous cross examination fails to show that Kline knew any facts which would be notice of defect in the title of the Trust Company, and in truth there is nothing to show that there was any defect in its title.

Something was said in argument below as to the constructive knowledge imputable to Kline as a stockholder in the Loan Association. It is difficult to take the suggestion seriously. A stockholder is never affected with constructive notice of what the records of the corporation might disclose (always excepting the charter and by-laws). And even were he, there is nothing in this record to show what the facts are, as shown by the corporate records, the knowledge of which appellees seek to impute to Kline.

Constructive notice has no place in this case in any event.

> "To constitute notice of an infirmity in the instrument or defect in the title of the person nego-

tiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."

Par. 3359, R. Stat. Arizona, 1901, (Sec.) 56.

One who purchases a promissory note before maturity and for full consideration and to whom the note is at the time indorsed by the payee and holder, takes such note in the ordinary course of business; and the fact that the purchaser took such note relying wholly upon the sufficiency of the mortgage security, or for the purpose of acquiring the mortgaged property by foreclosure, will in no legal sense affect his bona fides.

Christianson v. Farmers Warehouse Assn., 5 N. D. 438; 67 N. W. 300.

ASSIGNMENT OF ERROR V.

The District Court erred in holding that said Kline take nothing by his said action and that he is not the owner of nor entitled to possession of any of the securities or assets being the subject of said litigation, for the reason that the undisputed competent evidence in said cause shows that the said Arizona Mutual Savings & Loan Association clothed the Arizona Trust Company with apparent title to the collateral the subject of this litigation, and placed said Trust Company in possession thereof and thereby gave the said Arizona Trust Company the opportunity to pledge said collateral to said Kline he being an innocent purchaser for value, thereby estopping the said Arizona Mutual Savings & Loan Association and its said receiver, Sims Ely, from claiming

said collateral as against the said Kline until the payment of the note to secure which said collateral was pledged. (pp. 53-54, Transcript).

The weight of authority and better reasoning appears to be that in case of negotiable paper transferred *subsequent* to maturity a prior party clothing one with apparent title by delivery to him of such instrument endorsed in blank is estopped to contest the title of a holder who has parted with value upon the faith of such apparent title.

Moore v. Moore, 112 Ind. 149; 13 N. E. 673.
May v. Martin, 32 Tex. Civ. App. 132; 73 S. W. 840.

In this case the Loan Association had clothed the Trust Company with apparent title and possession of the notes in suit under blank endorsement. Kline parted with his stock to the Trust Company upon the faith of this title. The Loan Association and its Receiver should be estopped to contest the title he thus acquired.

ASSIGNMENT OF ERROR VII.

The District Court erred in holding that said Kline had any notice or knowledge of the insolvency of the said Arizona Mutual Savings & Loan Association or defect in the title of the Arizona Trust Company to said collateral, at the time of the pledging of said collateral.

We invite the court's attention to the testimony which is short and is found at pages 83 to 102 of the transcript.

ASSIGNEMENTS OF ERROR VIII AND IX.

VIII.

The District Court erred in entering judgment in

favor of the defendants herein, said judgment being contrary to the law and the competent evidence in the case. (p. 54, Transcript).

IX.

The District Court erred in not rendering judgment in favor of the appellant in accordance with the prayer of the bill (p. 55, Transcript).

If we are correct in our contention that the trial court erred in admitting and considering the decrees in the Clark litigation as against Kline the decree appealed from is wholly without evidence to support it as there is no other evidence of defect in Kline's title to the collateral.

If the decrees were properly considered we contend that Kline is entitled to the benefits of the protection accorded to an innocent purchaser of unmatured commercial paper except as to the Wardlop note, which was purchased subsequent to maturity.

As to the Wardlop note, we contend that the Loan Association is estopped to claim title as against Kline.

Upon the whole case, and in view of the statement of counsel, page 105, Transcript:

> By Mr. Stoneman: We think, as has been developed in this hearing this afternoon, that the facts as far as they can be are pretty well admitted and agreed to. We have no evidence which I could submit which would aid the Court in any way upon the facts in the case, and therefore are not submitting any evidence because of an agreement with Mr. Lewis that the defendants were not to be called upon to

submit certified copies of the two decrees pled in the answer which Mr. Lewis and I have agreed contain the facts so far as they are referred to in the answer. Is that true, Mr. Lewis?

By Mr. Lewis: That is correct. We make no objection to the form of the proof. We do object to the competency and relevancy of the judgments themselves upon the ground that we were not parties to this litigation and that our interest, if any we had, initiated prior to the institution of that suit, and therefore we are not barred by any decree which may have been rendered in the Clark litigation.

By Mr. Stoneman: With that exception it may be stipulated then that we will use in this suit the two decrees as they appear in the records in this court?

By Mr. Lewis: That is correct.

we ask that the decree entered below be reversed, and that the court deem the record as equivalent to a formal case agreed, and direct the District Court to render a decree in accordance with the prayer of the bill of complaint upon the undisputed facts shown by this recrd.

Respectfully submitted,

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